



City of Seattle

Office of City Auditor

Susan Cohen, City Auditor

DATE: June 10, 2005

TO: Mayor Greg Nickels
City Councilmembers

FROM: Susan Cohen, City Auditor *Susan Cohen*

RE: Use of Unpredictable Revenues for Capital Projects

Summary and Conclusion: Use of Unpredictable Revenues for Capital Projects

Best practices for funding capital projects involve reliance on outside funding include:

- (1) Assurance that the outside funding will materialize through a letter of agreement or another written and signed document from the outside party; and
- (2) The development, prior to the authorization of a project, of acceptable alternative, contingency plans, if predicted revenue sources do not materialize.

We strongly encourage the City to adopt similar policies.

Objective and Methodology

We investigated best practices regarding reliance on unpredictable funding sources for capital projects at the request of Councilmember Nick Licata.

To perform this work, we researched best practices information from the Government Finance Officers Association (GFOA) and the Federal Office of Management and Budget. We also interviewed staff from seven cities similar in size to Seattle. We found that the jurisdictions we surveyed do not proceed with projects without, at a minimum, some form of written agreement from expected external funding sources, or an advance plan in place to cut costs if revenues don't meet predictions. We provide details on the information we gathered in the remainder of this letter.

Best Practices

The GFOA has established "Best Practices in Public Budgeting," including a practice to formally adopt a financial policy addressing unpredictable revenues:

A government should identify major revenue sources it considers unpredictable and define how these revenues may be used. ...A government should decide, in advance, on a set of tentative

actions to be taken if one or more of these sources generates revenues substantially higher or lower than projected. The plans should be publicly discussed and used in budget decision making. (National Advisory Council on State and Local Budgeting, Government Finance Officers Association, Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting, Practice 4.4a, <http://www.gfoa.org/services/df/budget/RecommendedBudgetPractices.pdf>)

The Federal Office of Management and Budget circular *Planning, Budgeting, Acquisition, and Management of Capital Assets*, warns of the predictable risks of proceeding without assured funding and requires full funding appropriation for each segment or module of a project in advance:

300.6 How are capital asset acquisitions funded?

(a) Background.

Good budgeting requires that appropriations for the full costs of asset acquisition be enacted in advance to help ensure that all costs and benefits are fully taken into account when decisions are made about providing resources. For most spending on acquisitions, this rule is followed throughout the Government. When capital assets are funded in increments, without certainty if or when future funding will be available, it can and occasionally does result in poor planning, acquisition of assets not fully justified, higher acquisition costs, project delays, cancellation of major projects, the loss of sunk costs, or inadequate funding to maintain and operate the assets.

(b) Full funding policy.

The full funding policy (see section [31.4](#)) requires that each useful segment (or module) of a capital project be fully funded with either regular annual appropriations or advance appropriations. For definitions of these terms, see section [300.4](#) or the Glossary to Appendix 300A. Appendix 300A elaborates on the full funding concept (see the Principles of Financing section).

For the initial budget submissions, you are required to request full budget resources for all ongoing and new proposals for capital assets or at least for each useful segment of a capital project.

Identify in the initial budget submission any additional budget authority required to implement full funding for existing projects. Adjustments to your planning guidance levels will be considered based on your budget submissions.

Survey of Other Jurisdictions

We surveyed seven jurisdictions regarding their practices with respect to beginning capital projects with unpredictable funding sources. Six of the seven indicated they don't proceed with a project until funding is assured. The seventh – Kansas City – takes steps to mitigate the risks if they proceed without assured funding. Exhibit 1 summarizes the information we gathered from other jurisdictions. We conclude from this research that it is a standard best practice to plan in advance for unpredictable funding sources, and not to initiate a capital project until all partners in a project have committed to their share of the funding.

Recommendation

Adopt a financial policy regarding unpredictable funding sources for capital projects.

Require that a plan be in place in advance of inviting bids for a capital project to either

- Phase the project (if building only some of the phases still serves a City purpose);
- Develop parts of the project as alternates that can be foregone if full funding does not materialize (if this can be done without compromising the City purpose of the project); or
- Identify contingency plans should the revenue not meet expectations.

Exhibit 1: Practices Regarding Unpredictable Funding Sources

Jurisdiction	Practices Regarding Unpredictable Funding Sources
Mesa, AZ	Project is held until funding is assured.
Atlanta, GA	They don't proceed without funding.
Denver, CO	Generally they won't start without assured funding, but they proceeded with an opera house awaiting funds from fundraising. They developed alternates that could be cut if fundraising goals were not met. Auditor must sign off that funding is in hand before proceeding.
Virginia Beach, VA	They require a letter of commitment for funding before proceeding.
Kansas City, MO	They will proceed on basis of estimated contributions, but include incentives ("poison pills") in advance agreements to ensure the City is protected if partners don't deliver.
Oklahoma City, OK	Multi-party funding agreements must be signed before the project can proceed.
Portland, OR	The Office of Management and Finance is vigilant and "pulls the plug" on a project if the funding isn't coming through.

If you have any questions, please call me at 233-1093.